# COST CONTROL IN RETAIL FOOD STORES

by use of

# WHOLESALERS' ACCOUNTING SERVICES

MARKETING RESEARCH REPORT NO. 411



Agricultural Marketing Service
Transportation and Facilities Research Division
U. S. DEPARTMENT OF AGRICULTURE

## PREFACE

The sales volume of retail food stores formally affiliated with a wholesale organization has increased rapidly in recent years. Trade estimates place the annual volume handled by these stores at $22.5 billion, or over 45 percent of the total sales of retail food stores. Research that contributes toward more effective cooperation between the wholesale food distributor and retailer can materially help hold down the cost of marketing at both levels of the marketing system. This report is issued as part of a broad program of marketing research in the Agricultural Marketing Service aimed at increasing the efficiency of marketing and expanding markets for farm products.

Savings in marketing costs are usually reflected in better prices to the farmer for his product, in lower prices to the consumer, or in some advantage to each. More efficient marketing, therefore, benefits all--producers, processors, distributors, and consumers.

This is one in a group of reports concerned with wholesaler-retailer cooperation to hold down the costs of food distribution.

The following reports are available on request to the U. S. Department of Agriculture, Office of Information, Washington 25, D. C.:

"The Use of Fieldmen by Wholesale Food Distributors and Affiliated Retailers," Marketing Research Report No. 226.

"Views of Independent Grocers on Wholesaler-Retailer Relations," Marketing Research Report No. 42.

The following reports can be consulted in libraries or can be purchased from the Government Printing Office, Washington 25, D. C.:

"How Some Wholesale Grocers Build Better Retailers," Marketing Research Report No. 12 (30 cents)

"Methods of Handling and Delivering Orders Used by Some Leading Wholesale Grocers," Marketing Research Report No. 13. (35 cents)

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## SUMMARY

Close coordination of the food wholesaling and retailing functions has been one of the important factors contributing to efficiency in agricultural marketing. One of the most significant of recent developments in food wholesaler-retailer cooperation is wholesaler handling of store accounting for associated retailers. This provides both wholesaler and retailer management with more accurate and timely information on the store's operation, and, hence, with insights which can increase retailer efficiency. U. S. Department of Agriculture researchers studied seven leading wholesale organizations providing accounting service and discussed the subject with a score of their retailers who had experience with the service; case studies were prepared. The work was done during 1958-59; the firms are in the East, Midwest, and Southwest regions of the United States. The research was initiated because useful accounting information is being made more readily available to food retailers--but many need to learn how to use such data in controlling their costs.

As part of the accounting service, the wholesaler usually supplies the retailer with forms for original entry of store data and from these the periodic accounting statements are prepared. In addition, the wholesaler prepares the various Federal, State, and local tax returns which pertain to store operations.

To help retailers evaluate their operations, some wholesalers who offer accounting service also provide composite operating figures of comparable volume stores to retailers participating in the service. Such comparative statements, covering similar types of retailers in similar trading areas--when limited to better-than-average operators--offer useful standards for the individual retailer.

Accounting systems provide retailers with information on costs of goods sold, operating expenses, and net earnings--key indexes of a store's operation. Where the ratio of costs of goods sold to sales is out of line, the retailer may probe for the specific cause and then seek to correct it. For example, he may look into: (1) Procedure for receiving and checking-in all merchandise, particularly that which is brought in by vendors, (2) the pricing of merchandise on the invoice, particularly where price extensions are done by hand rather than mechanically, (3) records of merchandise shrinkage, especially in produce and meat departments, (4) procedures for employee purchasing and check-out in the store to assure integrity at service counters and check-out stands, and (5) product and price "mix" in each department to assure a good balance of sales between items of small and large margin.

When expenses are high, particularly those which can most readily be controlled in day-to-day store operations, the retailer may search for the specific cause. For example, if wage and salary expenses are high, he needs to look into: (1) Work organization--between departments and between full- and part-time employees, between shifts and between days of different sales volume, (2) working facilities--their adequacy and proper use, (3) work methods used, (4) the morale and motivation of employees, and (5) management salaries, in the light of the store's sales volume and the wages paid to department heads.

In order to make effective use of accounting data, retailers need to study their statements in systematic fashion. The order of reading and analyzing a profit and expense statement is as follows: (1) Net profit for the current period should be compared with those for previous periods, (2) the store's overall sales and sales per customer should be compared with those for other periods, (3) of the direct and allocated expenses, those for wages and salaries are most important and raise questions of sales per man-hour and store operating efficiency, (4) the earnings and operations for each department are next checked; the sales figures--in dollars and as a percent of store totals--are studied; questions are raised on shrinkage and pilferage, on pricing, and on the efficiency of the department's operations, and finally, (5) indirect store expenses are studied for clues to holding down costs.

Accounting service for the retailer is another expense and needs to be scrutinized carefully as to cost and contribution to the store's profitable operation. Accounting is also a tool of store management and, used effectively, can save far more than it costs.

## COST CONTROL IN RETAIL FOOD STORES

## BY USE OF WHOLESALERS' ACCOUNTING SERVICES

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### INTRODUCTION

Retail food stores are an integral part of the agricultural marketing system and efficient retailing can help hold down marketing costs for farm products. The efficient management of retail food stores today requires a great deal of precise information about the store's operation. What are labor costs for the store? How many times a year does merchandise turn over? Are expenses higher this year than last? In which department of the store are expenses and shrinkage higher than normal? A good accounting system can be a principal source of precise information on the store's operation.

This report is primarily concerned with the accounting problems of the independent food retailer. During the past decade, the number of retail food stores has dropped from about 356,000 in 1948 to 280,000 in 1958, 1/ despite an increase in total grocery store sales of almost 100 percent during this period. Margins for the independent retailer are largely determined on the one hand by his suppliers' prices and on the other hand by his corporate chain competition. If the independent retailer is to survive, he must hold his costs within the margins set for him; to do this he must know what his costs are and how to control them.

Accounting systems can provide retail food store managers with the means for knowing their costs, and hence, for taking actions to control them. Accounting systems provide retailers with a means of evaluating current operations and of determining weaknesses that may be corrected. If retailing efficiency can be increased and marketing costs, thereby, held down, the savings are likely to be reflected in better prices for the consumer, the farmer, or partially, to both.

The research for this report was initiated because useful cost accounting information is becoming more readily available to food retailers, yet many have failed to apply such information in controlling their costs. They have

1/ The 1948 figure is from the U. S. Census of Business, 1948; the 1958 figure is a "Progressive Grocer" estimate based on the U. S. Census of Business, 1954. An independent food retailer is defined by "Progressive Grocer" as an operation of less than 11 stores.

not used the information largely because they have lacked knowledge on how to analyze accounting statements and how to apply the data to locate operating weaknesses. This report is designed to help food retailers analyze their statements, locate problems in store operations, and to hence take steps increasing efficiency.

This report describes accounting services used in some leading food wholesaler-retailer organizations and how food retailers have used the accounting information to improve their operation. Studies were made of seven leading wholesaler-retailer organizations and two or three of each firm's affiliated retailers who have been using the retail accounting service provided. Case studies were prepared of the wholesaler's accounting services and of each retailer's experience with the service; some of these case studies are briefly described. Most of the studies were made during 1958 and 1959; the firms are located in the East, Midwest, and Southwest regions of the United States.

## WHOLESALER-RETAILER ACCOUNTING SYSTEMS AND SERVICES

One of the recent developments in wholesaler-retailer cooperation is the accounting service provided by the wholesaler for associated retailers. In most cases the initiative has come from a handful of retailers urging their suppliers to take on the task of filing the various tax returns required of retail food store operators. These retailers have felt that the work could be done at lower cost for the individual store by having a centralized accounting service. When the wholesaler or the cooperative food distributor has taken on this work, more and more retailers have asked for more inclusive accounting service.

Retailers visited in this study often commented that their wholesale food distributor was in a good position to offer this kind of service. 2/ He has an intimate knowledge of the retail food operation and provides many other kinds of retailer services, such as store engineering, merchandising counsel, and advertising. The accountants hired by the wholesale food distributor may specialize in retail food store accounting, and their familiarity with many retail stores can be helpful to individual operators. The voluntary and cooperative group of retailers is a readymade group which provides the volume of work necessary to support full-time salaried accountants. The individual retailer gains particularly through comparisons of operating figures with similar stores in the trading territory.

2/ Of course, there are other ways for the independent retailer to obtain the benefits of a sound accounting system. Some of the national trade associations in the food retailing industry have developed comprehensive accounting systems and the forms on which accounts are kept. The material of the National Association of Retail Grocers of the United States and of the Cooperative Food Distributors of America are examples of this. Some individual accountants and accounting firms specialize in accounting for retailers and have considerable experience in the food industry.

## Organization of Accounting Service

The retail accounting services provided by the wholesalers are similar in many ways. The accounting department is usually under the treasurer of the company, though at the same time closely associated with the store development section or the sales manager. The store development manager and field representative usually work closely with the retail accounting department, though store operating figures are not made available to the store development personnel without permission of the retailer. Store figures are usually kept confidential.

Under the treasurer or a controller, accountants work with bookkeepers on the store accounts. In most instances accountants are familiar with every retail account and work on them interchangeably. In one company, however, an accountant is assigned to a specific number of accounts for which he is responsible. He works only on these accounts with two bookkeepers. As more retail store accounts are added to the service, additional accountants are hired.

## Operation of Retail Accounting Departments

The operation of retail accounting departments varies with the number of stores in the service, the type of service offered, and the manner of communicating store accounting data to the retailer. The accounting services vary greatly in the extent of personal contact with the retailer. Most retail accounting systems provide for visits with the retailer by members of the accounting department only when the operating statement indicates the store is in serious trouble. The accountant may then arrange for a meeting time with the retailer to review the operating statements, try to determine the reasons for the difficulty, and, if feasible, recommend a solution to the problem. In most of the systems studied, operating statements are mailed to the retailer for his own analysis. One of the systems studied does not provide for visits to the store; the accountants send written analyses with each operating statement.

A letter of analysis appears to be the most practical and useful way to handle store contacts, particularly for those retailers who are familiar with accounting data and their use. To send a letter with each statement requires the accountant to take a close look at each operating statement and analyze it systematically. This is the best way to maintain familiarity with the operation and catch any difficulties before they become serious. Many retailers interviewed admitted they were not skilled at analyzing operating statements, and without the accountant's analysis were likely to look at the net profit figure and some major expense items, and then put the statement aside without further study.

In most systems each retailer mails his bookkeeping data to the accounting department every week. Most accounting departments provide the forms used by their retailers for listing the information and special self-addressed envelopes for mailing. Using standardized forms makes data processing easier

for the accounting department and, usually, is an efficient method for the retailer to assemble the needed information. Although the forms used by the different accounting systems vary, they are all designed with the same objective in mind: To make recordkeeping as easy and systematic as possible for the retailer. The principal forms that must be kept by the retailer under the systems studied are:

A cash receipt record, by departments

A cash paid-out record, by department and item

A payroll record

A cutoff time report telling the accounting department what expenses and income should be included in each period

All this information is kept on two or three forms. 3/ A record of cash receipts and paid-outs by each department is usually kept on a single daily store report. A monthly report or summary sheet provides information on the unpaid merchandise purchases and unpaid expenses. Data on wages are kept either on a monthly payroll report or simply included in the check register. The check register requires no additional work by the retailer and is widely used. These are the principal sources of information from which the income and expense statement and the balance sheet are prepared.

Accurate information on inventories is an essential part of a good accounting system. The accounting departments request that a produce and meat inventory be taken regularly, usually weekly, and most of them also require a grocery inventory, usually on a quarterly basis. If statements are prepared for the retailer between inventories, the grocery inventory is estimated on the basis of the previous inventory. Retailers can usually arrange, through their wholesaler's accounting service, to have the store grocery inventory taken. In the firms studied, the accounting service supplies men from the grocery warehouse to take inventory at an hourly fee, plus a fee for the use of calculators. A complete store inventory, taken after store hours, usually takes about 4 hours.

Operating statements are sent to the stores monthly, quarterly, or every 4 weeks. The advantage of the 4-week statement is that all periods are uniform--it eliminates the 5-week months, which means that dollar figures will be more nearly comparable. For smaller firms, after the accounting service has been used for a year or more, quarterly statements may be adequate.

The statements furnished usually include the operating figures for the current period, the same period last year, and for the entire past year. (See typical income and expense statement, figure 1.) These comparative figures,

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3/ As indicated in footnote 1, several of the national trade associations have developed retail accounting procedures, including manuals and forms for original entry.

INCOME AND EXPENSE STATEMENT

| SALES AND EXPENSES ITEMS | | | CURRENT PERIOD From ___ To ___ | | SAME PERIOD LAST YEAR | | TOTAL LAST YEAR | |
|---|---|---|---|---|---|---|---|---|
| | | | Dollars | % | Dollars | % | Dollars | % |
| GROCERY SALES - NET | | | | | | | | |
| Pre-Inventory | | | | | | | | |
| Purchases | | | | | | | | |
| Total | | | | | | | | |
| Less: New Inventory | | | | | | | | |
| Cost of Goods Sold | | | | | | | | |
| GROCERY GROSS PROFIT | | | | | | | | |
| MEAT SALES - NET | | | | | | | | |
| Pre-Inventory | | | | | | | | |
| Purchases | | | | | | | | |
| Total | | | | | | | | |
| Less: New Inventory | | | | | | | | |
| Cost of Goods Sold | | | | | | | | |
| MEAT GROSS PROFIT | | | | | | | | |
| PRODUCE SALES - NET | | | | | | | | |
| Pre-Inventory | | | | | | | | |
| Purchases | | | | | | | | |
| Total | | | | | | | | |
| Less: New Inventory | | | | | | | | |
| Cost of Goods Sold | | | | | | | | |
| PRODUCE GROSS PROFIT | | | | | | | | |
| COMBINED SALES | | | | | | | | |
| COMBINED COST OF GOODS SOLD | | | | | | | | |
| COMBINED GROSS PROFIT | | | | | | | | |
| EXPENSES | | | | | | | | |
| MANAGEMENT SALARIES | | | | | | | | |
| EMPLOYEES' WAGES - GROCERY | | | | | | | | |
| MEAT | | | | | | | | |
| PRODUCE | | | | | | | | |
| UTILITIES (heat, light, power & phone) | | | | | | | | |
| STORE SUPPLIES - GROCERY | | | | | | | | |
| MEAT | | | | | | | | |
| PRODUCE | | | | | | | | |
| REPAIRS & MAINTENANCE | | | | | | | | |
| ADVERTISING | | | | | | | | |
| TAXES - PAYROLL | | | | | | | | |
| TAXES - PERSONAL PROPERTY | | | | | | | | |
| LICENSES | | | | | | | | |
| BAD DEBTS | | | | | | | | |
| DEPRECIATION | | | | | | | | |
| BOOKKEEPING | | | | | | | | |
| SUPERVISION FEES | | | | | | | | |
| INTEREST EXPENSE | | | | | | | | |
| INSURANCES | | | | | | | | |
| BANK CHARGES | | | | | | | | |
| LAUNDRY | | | | | | | | |
| SUNDRY EXPENSES | | | | | | | | |
| STORE RENT | | | | | | | | |
| EQUIPMENT RENTAL | | | | | | | | |
| EXCISE TAX | | | | | | | | |
| FEES AND FREIGHT | | | | | | | | |
| TOTAL EXPENSE | | | | | | | | |
| OPERATING PROFIT | | | | | | | | |

THIS STATEMENT PREPARED FROM UNVERIFIED INFORMATION

Figure 1.--Example of an income and expense statement.

when set forth on one page, help to point up the course the store is taking and to make analysis of the current statement easier.

## Services Offered by Retail Accounting Departments

All the retail accounting programs studied provide tax return service. The tax service includes all Federal and State taxes and any local taxes pertaining to store operations. From the data supplied by the retailer, the store accounting service will prepare quarterly statements of Federal withholding taxes and annual statements of employee income and taxes. Unemployment compensation payments, both Federal and State, social security statements, and excise tax returns, as well as sales tax returns, are also prepared. Most of the accounting services studied also review new laws that may affect retailer recordkeeping and accounting practices and send retailers summaries of the laws.

Some of the accounting departments analyze the retail store's insurance needs and make recommendations for insurance coverage. As part of this service the accounting department keeps an up-to-date list of all store equipment and fixtures with the price and value of each. This information is invaluable to the store in case of fire or other loss. In some cases the accounting service will work directly with the insurance company in making settlement.

To help participating retailers compare their operations with those of other stores, most accounting departments compute operating figures for groups of stores with similar volume. An operating statement is made up for each volume group and sent to all stores in the group. These averages include poor store operations as well as good ones and thus are not suitable for use as standards or goals. Some accounting departments include only the better store operations in each volume group--for example, 10 topnotch operators--and label them as such, thereby giving most of the stores in each group a goal to work for. These comparative statements are one of the most valuable adjuncts to the retailer accounting service provided by the wholesaler. But, to be most helpful, comparisons should be with operations which challenge the retailer to improve his own, rather than comparisons which encourage him to say, "I'm better than most and that's good enough."

Some of the accounting services provide operating ratios with each statement. The most commonly used ratio is sales per customer. Other ratios occasionally provided are sales per square foot of selling area, sales per man-hour, and rate of merchandise turnover. These ratios are very useful in analyzing store operations but require adequate retailer understanding to be most helpful. (See the section on "Operating Ratios" for further details.)

Most wholesalers make special analyses and reports available for retailers, sometimes regularly and sometimes as the need arises. Among such reports are: Turnover and tonnage reports on produce and meat department operating budgets (particularly for new or remodeled stores), and financial prospectuses when required by the retailer to acquire new or additional financing.

One of the accounting departments provides for centralized payment of bills. All of the store's bills are sent to the accounting department, except small vendor bills which are paid from the cash register. This service requires close cooperation between the accounting department and the store, but it frees the store manager from much of the office work, and is reported to be very helpful by the stores that have been using this service.

### Fees for Retail Accounting Service

Retailers were asked, as part of the study, how they use the wholesaler's accounting service and how it compares with their previous accounting arrangements. These retailers said they were receiving better accounting service at a lower cost than under their previous arrangement.

The retailers are usually billed monthly for the accounting service, which costs from $20 to $60, depending on the retailer's volume and on the services he received. The fee schedule for the basic accounting service of one wholesaler ranged from $25 for a 4-week period for stores doing up to $10,000 in sales for the period, to $50 for 4 weeks' service for stores with sales over $120,000 for the period.

Other charges were for: Work on the journal ledger, check register, etc., billed at cost; special accounting services for the individual firm charged on the basis of time; and the owner's personal Federal income tax at extra fee. Figure 2 gives a comparison of the accounting services offered by the wholesalers studied.

## KINDS OF INFORMATION OBTAINED FROM ACCOUNTING SYSTEMS

A good accounting system can provide many different kinds of information to help the retailer make sound operating decisions. 4/ Accounting statements tell the retailer what has been going on in his business for a given period of time with a preciseness not otherwise possible. Some of the kinds of information which are directly useful in improving store operations are discussed below.

### Income and Expense Information

One of the most useful reports an accounting system provides is the statement on income and expenses. 5/ Usually prepared on a monthly or quarterly

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4/ Many kinds of information provided by accounting systems are not discussed here; for example, the information in a balance sheet may be useful for a banker or credit agency, but is of lesser value in helping the retailer make day-to-day operating decisions.

5/ This has often been referred to as the "profit and loss" statement and more recently as the "income" statement. In this report the term used is "income and expense statement" since this is most descriptive of the information provided and focuses attention on the need to examine not only income (or profit figures) but also expense figures--as a way of controlling costs.

| Item | Firm A | Firm B | Firm C | Firm D | Firm E | Firm F | Firm G |
|---|---|---|---|---|---|---|---|
| Statements | | | | | | | |
| Income statement | Monthly | w/Inv. | 4 weeks | Quarterly | O.R. | Monthly | Monthly |
| Balance sheet | Quarterly | w/Inv. | 4 weeks | Quarterly | O.R. | Monthly | Quarterly |
| Written analysis of statements | None | W.N. | E.S. | None | None | None | W.N. |
| Tax Returns | | | | | | | |
| Sales tax | None | None | W.N. | W.N. | W.N. | W.N. | W.N. |
| Federal withholding | Quarterly | Quarterly | Quarterly | Quarterly | Quarterly | Quarterly | Quarterly |
| Year-end taxes | Annually | Annually | Annually | Annually | Annually | Annually | Annually |
| Unemployment tax returns | | | | | | | |
| Federal | Annually | Annually | Annually | Annually | Annually | Annually | Annually |
| State | Quarterly | Quarterly | Quarterly | Quarterly | None | Quarterly | Quarterly |
| Social security payment | Quarterly | Quarterly | Quarterly | Quarterly | Quarterly | Quarterly | Quarterly |
| Excise tax returns | Quarterly | Quarterly | Quarterly | None | None | None | None |
| Personal income tax | O.R. | O.R. | O.R. | O.R. | O.R. | O.R. | O.R. |
| Other Accounting Service | | | | | | | |
| Record of all equipment and cost for insurance | None | Yes | Yes | None | None | Yes | None |
| Analysis of insurance | None | O.R. | Annually | O.R. | None | Annually, O.R. | O.R. |
| Centralized payment of bills | Yes 1/ | None | None | Yes | None | None | None |
| Reconcile bank statement | None | Monthly | Monthly | Monthly | O.R. | O.R. | O.R. |
| Comparative operating figures | None | Frequent | Semi-Ann. | W.N. | None | Regular | Regular |
| Operating ratios | None | E.S. | E.S. | O.R. | None | O.R. | O.R. |
| Supply forms for in-store records | Some | Yes | Yes | Yes | None | Yes | Some |
| Provide area or trade statistics | None | Frequent | O.R. | None | None | O.R. | None |

O.R. - On Request; E.S. - With Each Statement; W.N. - When Necessary; w/Inv. - Statements sent after each inventory--Firm B recommends inventory every 6 weeks; N.A. - Not Available.

1/ For group of 10 stores in which wholesaler had a financial interest.

Figure 2.--Comparison of retail accounting services.

basis, this report tells the retailer about his sales, gross profit, expenses, and net profit. Where these figures are compared with similar periods of the store's operation, it is possible to observe trends in sales, profit, and expense categories. These trends, when considered against the background of known events in the locality, the industry, or the national economy, furnish first clues to problems in a store's operation. The meaning of profit and expense percentages in relation to sales is clearer when comparisons are made with operating statements for a group of comparable stores in the same period. Several of the wholesalers include such composite operating statements as part of their retailer accounting service. Figure 3 illustrates one form of composite income and expense statement.

## Operating Ratios

Operating ratios, such as sales per customer, sales per man-hour, sales per square foot, and inventory turnover, are also valuable tools for improving operations. These ratios are relatively easy to obtain and have the value of making it possible to compare operations from month to month and year to year.

The average sales per customer, for example, is obtained by dividing the number of cash register "totals" into total sales. This figure will tell if customers are doing most of their shopping at the store or just supplementing their food needs. When used together with the proportion of sales made by each department the ratio of sales per customer can help store management locate weak departments.

Another useful ratio, sales per man-hour, is computed by dividing total hours worked into total sales for the week. This ratio is a good index to the productivity of store employees and becomes particularly meaningful when compared with other stores of about the same size and volume in the same trading territory.

The ratio of sales per square foot of selling space is computed by dividing the total selling area into total weekly sales. This figure is useful in determining whether satisfactory use is being made of the available selling area.

Inventory turnover is computed by dividing the average dollar inventory carried in the store into the total sales for the year. Turnover rates will vary widely, depending on the type of operation. (For example, a store selling a large volume of produce will probably have a better overall turnover rate than a store with a small produce volume.) In any event, the ratio is valuable in indicating if optimum use is being made of the store's investment in inventory.

## Departmental Contribution to Overhead

Another tool available to the store operator through a good accounting system is information on the "contribution to overhead" of each department in the store. Contribution to overhead (C.T.O.) accounting is used extensively

| | Dollars | Percent of total sales |
|---|---|---|
| **SALES:** | | |
| Grocery sales | 65,367.08 | 67.69 |
| Meat sales | 24,203.36 | 25.06 |
| Produce sales | 6,995.08 | 7.25 |
| TOTAL SALES | 96,565.52 | 100.00 |
| **GROSS PROFIT:** | | |
| Grocery gross profit | 9,901.20 | 15.15 |
| Meat gross profit | 4,343.72 | 17.95 |
| Produce gross profit | 1,639.76 | 23.44 |
| TOTAL GROSS | 15,884.68 | 16.45 |
| **LESS OPERATING EXPENSES:** | | |
| Salaries | 654.60 | .68 |
| Wages | 5,494.96 | 5.69 |
| Advertising | 331.56 | .34 |
| Group advertising | 104.84 | .11 |
| Sales promotion | 109.44 | .11 |
| Stamps | 2,026.44 | 2.10 |
| Coupons | 82.56 | .09 |
| Rent | 878.44 | .90 |
| Utilities | 592.36 | .62 |
| Supplies | 720.08 | .74 |
| Freight | 402.00 | .42 |
| Linen | 96.84 | .10 |
| Grocery service charge | 18.08 | .02 |
| Meat service charge | 5.80 | .01 |
| Accounting and legal | 90.32 | .09 |
| Grocery and produce supervision | - | - |
| Meat supervision | - | - |
| Bank charges | 9.64 | .01 |
| Office expense | 17.28 | .02 |
| Bad debt expense | 2.24 | - |
| Dues and subscriptions | 7.32 | .01 |
| Donations | 3.48 | - |
| Interest | 181.28 | .19 |
| Repairs and maintenance | 179.16 | .18 |
| Insurance | 192.92 | .20 |
| Employees' welfare | 112.12 | .12 |
| Property taxes | 111.48 | .11 |
| Payroll taxes | 236.64 | .25 |
| Other taxes | 150.80 | .16 |
| Depreciation | 755.56 | .78 |
| Delivery expense | 46.80 | .05 |
| Travel expense | 82.96 | .08 |
| Miscellaneous | 151.92 | .16 |
| TOTAL OPERATING EXPENSE | 13,849.92 | 14.34 |
| NET OPERATING PROFIT | 2,034.76 | 2.11 |
| OTHER INCOME | 846.20 | .82 |
| TOTAL OPERATING PROFIT | 2,880.96 | 2.93 |

Figure 3.--A composite income and expense statement for stores above $12,000 per week sales volume with stamps in a Midwest trading territory. (The figures used are for a hypothetical group of stores.)

in other industries, but to a limited extent in the food industry. The basic idea of C.T.O. is to allocate those expenses that are directly related to each department and subtract them from the gross profit of the department. The result is the contribution that the department makes to overhead. In this way, the manager of each department may be held responsible for the contribution his department makes to overhead and, hence, to net profits. The theory of C.T.O. accounting is that a department manager cannot be held responsible for expenses, such as advertising, utilities, insurance, rent, interest, etc., over which he has no control, but he can be held responsible for all expenses that directly result from the operation of that department.

The main advantage of the system is that it helps localize operating difficulties. For instance, if total store wages are high, the retailer can find out if one department is out of line. Wages may be high in one department and low in another, but the owner might not be aware of this with only an overall cost figure for store labor. The main difficulty of this approach is that the allocation of labor and other expenses is not exact. For example, part-time employees may be assigned to produce, grocery, and front-end tasks during the day, and recording the exact time spent on each assignment is difficult. In some multistore operations where direct expenses are budgeted for each department, store managers sometimes "help" a poor department by not charging it with a full share of some expenses. Figure 4 illustrates a typical C.T.O. income statement.

## CONTROLLING COSTS OF GOODS SOLD

Many retailers assume that the term "cost of goods sold" simply refers to the price of merchandise they purchase from their wholesalers and other suppliers. On reflection, however, they recognize that invoice price is only the starting point for determining cost of goods. The cost of goods sold is obtained by adding starting inventory at cost to purchases and subtracting inventory on hand at the end of the period. However, the invoice cost of goods may include charges for unsalable merchandise, and even charges for merchandise never delivered. The merchandise that is not eventually sold must be included in the price of merchandise to the store. If a store buys a case of 100 lemons for $4.50 and plans to sell them for 5 cents each, the store would have a profit of 50 cents, if all lemons were sold. However, if 2 lemons are stolen and 3 spoil, only 95 lemons can be sold. This raises the price of the lemons to the store from 4.5 cents each to 4.8 cents each and reduces the gross profit from 50 cents to 25 cents, a reduction of 50 percent.

### Detecting Problems of High Cost of Goods

If merchandise is purchased from a reputable supplier whose operation is reasonably efficient, the invoice prices are likely to be in line with those of other retailers in the trading area. 6/ Nevertheless, if expenses in the

6/ For purposes of this report, it is assumed that the invoice price of merchandise to the retailer is fair. The decision of the retailer to associate in the cooperative or voluntary group is based on this kind of assumption.

| Item | Total | | Grocery | | Meat | | Produce | |
|---|---|---|---|---|---|---|---|---|
| | Dollars | Percent of sales | Dollars | Percent of sales | Dollars | Percent of sales | Dollars | Percent of sales |
| Sales................ | 115,095.46 | 100.00 | 74,812.05 | 65.00 | 30,500.30 | 26.50 | 9,783.11 | 8.50 |
| Cost of goods sold... | 95,354.29 | | 63,852.08 | | 24,125.74 | | 7,376.47 | |
| Gross profit......... | 19,741.17 | 17.15 | 10,959.97 | 14.65 | 6,374.56 | 20.90 | 2,406.64 | 24.60 |
| Direct and allocated expenses: | | | | | | | | |
| Salaries 1/.. | 6,367.63 | 5.53 | 3,590.98 | 4.80 | 2,043.52 | 6.70 | 733.13 | 7.49 |
| Laundry...... | 164.10 | .14 | 55.30 | .07 | 83.30 | .27 | 25.50 | .26 |
| Repairs...... | 305.45 | .26 | 149.50 | .20 | 25.20 | .08 | 130.75 | 1.34 |
| Supplies..... | 790.06 | .69 | 414.70 | .55 | 301.66 | .99 | 73.70 | .75 |
| Freight...... | 417.75 | .36 | 312.00 | .42 | 80.50 | .26 | 25.25 | .26 |
| Service charge.... | 39.75 | .03 | 12.50 | .02 | 16.75 | .05 | 10.50 | .11 |
| Sundry....... | 97.10 | .08 | 50.00 | .07 | 15.80 | .05 | 31.30 | .32 |
| TOTAL DIRECT EXPENSES......... | 8,181.84 | 7.10 | 4,584.98 | 6.13 | 2,566.73 | 8.40 | 1,030.13 | 10.53 |
| CONTRIBUTION TO OVERHEAD......... | 11,559.33 | | 6,374.99 | | 3,807.83 | | 1,376.51 | |
| INDIRECT AND NON-ALLOCATED EXPENSES (OVERHEAD): | | | | | | | | |
| Advertising.. | 1,266.05 | 1.10 | | | | | | |
| Stamps....... | 2,255.87 | 1.96 | | | | | | |
| Rent......... | 1,170.35 | 1.02 | | | | | | |
| Utilities.... | 863.22 | .75 | | | | | | |
| Legal and audit..... | 126.00 | .11 | | | | | | |
| Interest..... | 403.38 | .35 | | | | | | |
| Insurance.... | 192.00 | .17 | | | | | | |
| Depreciation. | 1,116.42 | .97 | | | | | | |
| All other indirect expenses..... | 2,000.00 | 1.74 | | | | | | |
| Total overhead expenses..... | 9,393.29 | | | | | | | |
| Net profit (after owner's salary) | 2,166.04 | 1.88 | | | | | | |

1/ Includes wages, management salaries, and a proportionate share of checkout expense. (Figures and percentages are for illustrative purposes only.)

Figure 4.--Portion of income and expense statement showing departmental contribution to overhead.

store's income statement are reasonable yet the profit figure is low, this probably means that the actual cost of goods sold was high.

Each department in the store has some records which can help locate the cause. In the grocery department, for example, a record of changes in purchase prices and the extent to which they are reflected in retail prices will indicate if margins are actually at planned levels. In a period of rising prices changes made belatedly will tend to increase the ratio of cost of goods sold to sales since items sold must be replaced at the higher costs. In the produce department, records of spoilage and markdowns will help locate trouble spots. Comparing these records with those for previous periods or for similar stores will help disclose whether the cause is largely one of poor merchandise with attendant high proportion of spoilage and distress selling or whether other factors are involved. In the meat department, cutting tests can determine whether high costs of goods sold result from excessive waste, poor balance between cuts of different price, or some other factor.

## Ways of Controlling High Cost of Goods

Controlling cost of goods is an essential part of overall store operations control. Assuming that the invoice cost of merchandise and the planned retail margin are in line, there are several essential checks for assuring that sales will return the gross profits planned:

(1) Is a systematic procedure in force for receiving and checking-in all merchandise, particularly that which is brought in by vendors? (2) Are procedures for employee purchasing in the store and check-out understood, to assure accuracy at service counters and check stands? (3) Is a record kept on shrinkage of merchandise, especially in produce and meat departments, and is there a weekly review of these records? (4) Is there a periodic check on pricing of merchandise on the invoice, particularly where the price extensions are made by hand rather than mechanically? (5) Is there a periodic review of product and price "mix" in each department to assure a good balance of sales between items of small and larger margins? Some specific questions that might be raised in connection with these five points are indicated in the appendix to this report.

An actual case study of a $15,000-per-week store will serve to illustrate the value of accounting statements for management control over cost of goods.

## Case Study A

The partners of a metropolitan area store were having difficulty meeting their obligations from the middle of 1957 to June 1958. The accountant assigned to this store noticed in the quarterly inventories that about $500 per month was not accounted for. He told the owners of this shortage, but nothing was done, and the store operated on this basis for nearly a year. The monthly statements indicated that the store could barely pay its debts.

Net profit, after depreciation, for the first 6 months of 1958 was 0.08 percent of sales. A closer look at operating statements during the year indicated two lines of inquiry: Pilferage of merchandise and improper pricing at the checkout. Several corrective measures were taken in these areas:

1. New locks were put on all doors, and the back door was kept locked at all times.

2. One person was made responsible for receiving certain deliveries. The person had to check all items in and out and sign the bills.

3. Weekend specials were reviewed with all checkout girls, and prices for these items were posted on registers.

4. A sign with soft drink prices was placed in position visible to both customers and checkouts.

5. One man was made responsible for making grocery price changes. All changes were to be made before the store opened every Monday morning. The price changes were reviewed with cashiers.

6. No employee was allowed to check out his own purchases.

More frequent store inventories indicated a minimum of pilferage. Net profit for the fourth quarter of 1958 had increased to 1.44 percent without increasing prices.

## CONTROLLING EXPENSES - IMPROVING NET PROFIT

There are many reasons why expenses in a store may be high--just as there are many factors which affect the cost of goods sold. Net profit--what remains from gross profit after expenses are paid--is affected by both the cost of goods and the expenses incurred in selling them. Careful reading of the income and expense statement is a way of detecting unduly high expenses.

## Detecting Problems of High Expenses

There are two broad categories of expenses in retailing--expenses which can be controlled by store management in day-to-day operations, and those which remain relatively fixed through the year. Controllable expenses, principally labor costs, are often directly associated with sales. Fixed expenses such as rent and depreciation are not necessarily associated with sales volume. Nevertheless, fixed expenses, as well as controllable expenses, may be unduly high for a retailer's volume and may contribute to poor earnings for the store.

In order to detect expenses which are abnormally high, the retailer needs some standard with which to compare his income and expense statement. Several "standards" are available to most operators--some more useful than others. The primary standard for a retailer is his own operation for a previous period--this may be for a preceding month or quarter or the same month or quarter of the previous year. In general, a retailer should be able to explain any increase in expenses to his own satisfaction; if the explanation is not clear and satisfactory, then he should look into the situation and try to uncover the problem.

Another source of standards for a retailer is often provided by the wholesaler as part of his accounting service. A composite income and expense statement is made up for a group of stores with similar volume served by the wholesaler, and these composite or "average" figures are made available to subscribing retailers. Because the stores are similar in many important respects, such as buying from the same source, trading in the same geographic area, and using the same system of accounting and reporting, the comparisons can be useful. On the other hand, expense figures from a more varied group of stores, such as those reporting in a national trade association survey or in a study of operations in another part of the country, may not be of direct value, since the expense categories may mean and include different things, and many costs, such as wage rates, will vary widely between different parts of the country.

## Ways of Controlling Expenses

Controlling expenses is one of management's continuing tasks in running a retail food store. With supermarket net earnings running from 1 to 2 percent of sales, failure to control expenses can make the difference between red or black ink in the final figures. The statement of income and expenses will indicate the expense categories that are too high and hence the areas that need investigation. Some suggestions on what to look for in problem areas follow:

Wages are the single largest expense category and the one most susceptible to control by management. If wage and salary expenses are high, several questions should be asked.

1. Is the work organized properly: Between departments, between individuals within departments, between full-time and part-time employees, between shifts and across the week? Is a high payroll, incurred during peak selling

periods, maintained when business has slackened? Are overtime hours necessary?

2. Are the working facilities adequate and properly used? What is the situation for receiving groceries and perishables? What is the condition of work space and equipment for handling perishables?

3. Are good work methods used? Has the job been studied recently to see if it can be done with less effort and in less time? Has the recent USDA research in work simplification for retail food stores been studied? 7/

4. Is the morale and motivation of employees good? Tardiness, absences, and idleness on the job are often associated with poor morale. Has the recent research on employee morale and motivation been studied?

5. Management salaries are an expense item like those of other store employees, and should be realistically appraised in the light of the store's sales volume and the wages paid to department heads.

Supplies and linen expenses can be controlled. Has the ordering, storage and use of supplies and of linens been looked into recently? Advertising, sales promotions, and trading stamps (if any) are often associated with sales volume. For better control the cost of each should be separated and the effectiveness of each expenditure should be studied. Utility rates are fixed for the store, but retailers are aware of countless little ways in which savings in electricity and power may be effected. Repairs and maintenance costs will vary widely, but care in authorizing and paying for repairs--especially if there is more than one store--may help control these expenses. In general, control of expenses is accomplished by studying each expense category in the income and expense statements, and then carefully following through on those items which are not in line. (See appendix for a checklist of things to look for in controlling expenses.)

Sometimes a retailer will try to solve his management problem by seeking a higher margin on his sales, instead of analyzing his statement and trying to reduce expenses. The following case study is an actual experience illustrating this.

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7/ Among such publications are the following, obtainable on request from the U. S. Department of Agriculture, Office of Information, Washington 25, D. C.:

Anderson, D. L., Shaffer, P. F. and Hapner, F. S., "Improved Methods of Trimming Produce in Retail Food Stores." U. S. Dept. Agr. Mktg. Res. Rpt. 192, 46 pp., illus., 1957.

Harwell, E. M., Anderson, D. L., Shaffer, P. F., and Knowles, R. H., "Receiving, Blocking, and Cutting Meats in Retail Food Stores." U. S. Dept. Agr., Mktg. Res. Rpt. 41, 55 pp., illus. 1953. (Reissued in 1956 with no change in text.)

Harwell, E. M., and Shaffer, P. F., "Some Improved Methods of Handling Groceries in Self-Service Retail Food Stores." U. S. Dept. Agr., Mktg. Res. Rpt. 7, 118 pp., illus. 1952. (Reissued in 1957 with no change in text.)

## Case Study B

One midwestern food retailer with average weekly sales of about $6,000 saw his net earnings decline and thought that higher gross margins was the solution. He notified his wholesaler that he was going to seek another supplier in an effort to obtain better margins. The fieldman asked for and arranged a meeting with the sales manager and the retailer. The sales manager reviewed the operating statement with the retailer and compared the statement with that of other stores of similar size in the area. The sales manager agreed that cost of goods did appear to be high, but that since invoice prices were the same for the other retailers, the high ratio of cost of goods to sales must be a reflection of shrinkage and pilferage in the store. The sales manager also pointed out that labor costs were slightly higher than in comparable stores.

From these observations, it was concluded that the store's poor profit position resulted from lax control in the store and that better management, rather than higher margins, was the urgent need. Three recommendations were made:

1. Tighten "exits" of merchandise.

    The back door of the store should remain locked unless attended. Employees working in the evening should leave by the front. The register and checkout stand at the rear of store (at an exit to parking space) should be closed except during the Friday evening peak business.

2. Improve work organization.

    The assistant grocery manager should do general work around the store, under supervision of the store manager. Checkers should stock drug and frozen food departments during slack time. Department managers should be given incentive payments, based on department sales, in addition to their salaries.

3. Tighten control over ordering and inventories.

    The store manager should be responsible for ordering drugs, frozen foods, and dairy items. Purchasing of meat and produce should be concentrated to improve quality and reduce freight charges. Grocery ordering time should be scheduled better for weekend business needs. Grocery reserve stocks should be kept in one place in the store, rather than scattered, and inventories should be studied to eliminate unnecessary items.

**The results of the improved operations were evident in the store's financial position 6 months later. Without increasing prices, the gross profit in each department had improved: In groceries, from 15.29 to 17.61 percent; in meat, from 14.15 to 18.23 percent; and in produce, from 24.98 to 25.56 percent. Reductions in working hours, losses of merchandise, and spoilage were reflected in the net profit, which rose from 2.57 to 4.87 percent, before the owner's salary.**

## LEARNING FROM INCOME AND EXPENSE STATEMENTS

Retailers interviewed said they often look at only one or two key figures on their operating statements and if these figures are acceptable, the income statement is filed. However, retailers can probably learn a great deal more about their store's operation by studying the entire income and expense statement--even when the net profit figure looks good. The diagram in figure 5 illustrates a useful way of reading the income and expense statement and of utilizing operating ratios to uncover weaknesses in store operations. Following a systematic method of analyzing the statement points up the usefulness of the accounting data.

As illustrated, the first question is net profit. The net profit in the current period should be first compared with the net profit for the same period last year, and the year to date. One should keep in mind, however, that a preceding period should not be considered as a criterion or standard without other comparisons.

After net profit, one should inspect the figure for store sales and again make comparisons with previous periods. As many retailers pointed out, when net profit is down it is often the result of a decline in sales without a corresponding reduction in expenses. A look at the ratio of sales per customer may give clues as to the reason for a decline in business volume. A low or declining figure on sales per customer often means that the major, and perhaps more profitable, items are being bought elsewhere. This may suggest the need for looking at overall store layout or merchandising practices.

After looking at sales figures, the next step is to study direct and allocated expenses. It is in these categories that costs of operations may be reduced. If wage expense is high, as a percentage of sales, or if sales per man-hour are low, operations should be studied to see if increased efficiencies can be attained. Possible savings on salaries and other direct expenses should be investigated, too, if these items are abnormally high.

In addition to a study of overall store expenses, separate analysis should be made of each department. A first step is to examine the department sales in dollars and as a percentage of the total store volume. Comparison of current with previous periods can disclose departments which are not contributing adequately to the store's volume. This may suggest problems in pricing, merchandising, or in operations. Poor balance in pricing of

LOOKING AT A STATEMENT OF INCOME & EXPENSES

- to Determine Weaknesses in Store Operations

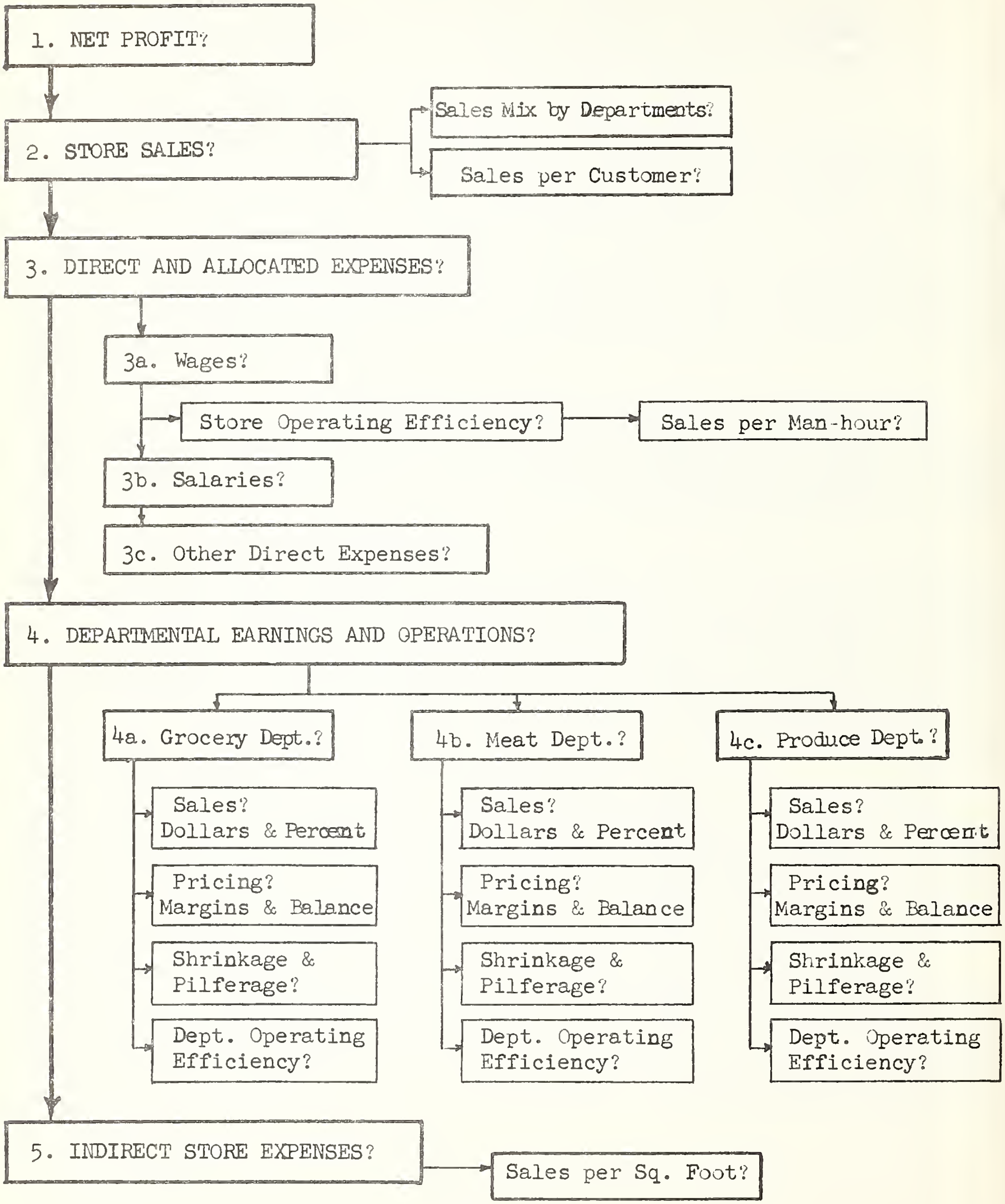


Figure 5

merchandise or belated price adjustments to meet changing costs or competitive situations may also have a bearing on the department's sales. Excessive shrinkage is often a problem in meat and produce departments showing poor profit. Pilferage in groceries and sometimes in meat may also be disclosed on close scrutiny of poor departments. Finally, and perhaps most obviously, a poor department showing may be traced to poor work methods and organization.

An analysis of general store expenses concludes a review of the store's operating statement. These expenses are relatively constant and can be little affected by store manager actions. A critical examination of them is important, however, particularly in the early periods of a store's opening or remodeling, to determine if these expenses are at budgeted levels.

The following case study, an actual experience, illustrates how the income statements can be analyzed systematically to determine the factors limiting a store's volume and to reach decisions on changing the store's basic operation.

Case Study C

In the fall of 1958 the owners of a store in a town of 3,000 in upper New York State reviewed their operating statements to consider the possibility of increasing their income from the business. The store had been founded a generation earlier. It had been sold to the two sons of the founder, who after a short period of retirement, was returning to the business. The issue, as viewed by the owners, was whether the present store could produce enough income for three full-time owners. The store had been in its present location since 1945 and had reached an annual volume of almost $1 million in a floor area of 3,200 square feet. A review of store operations of the past 3 years indicated a steadily growing volume--from $15,000 per week in 1956 to $17,800 in 1957 and $19,000 in 1958. Comparison with figures compiled by the wholesaler covering operations of other affiliated stores in their volume group showed that earnings had been extremely good. The wholesaler sales manager analyzed the statement with the owners, after which a decision was made to build a larger store.

The net operating profit for the third quarter of 1958 was 3.50 percent of sales. But since the operating profit of 2.37 percent for the first nine months of 1958 was less than the 3.09 percent in the corresponding period of 1957, it looked as though the figure for the 12 months of 1958 might fall below the 3.27 percent of 1957. The gross profit for 1958 was in line with the comparable period of 1957. An examination of the departmental gross profits revealed they were higher in the third quarter than in the two previous periods.

Expenses for the third quarter were running higher than a year earlier, and about the same as for the year to date, but this is more than explained by the introduction of a new "family stamp plan," at the cost of 2.5 percent of sales. Employees' wages were down, and fixed expenses, such as rent, utilities, repairs and maintenance, and taxes had remained at the same level. Sales per square foot of selling area for the current period were $6.20 - well above the average for similar stores in the area.

This analysis suggested that earnings were apparently limited largely by the physical size and overall volume of the store. If the owners wanted to realize a larger drawing, a larger volume business was necessary to carry it, and larger quarters were probably the best way to attain the desired sales level. The owners, in cooperation with the wholesalers, drafted plans for building a new store in the immediate future.

Income and Expense Statement of
Upstate New York Store

| Item | 3rd Quarter 1958 | First 3 Quarters 1958 | First 3 Quarters 1957 |
|---|---|---|---|
| | Percent of sales | Percent of sales | Percent of sales |
| Sales: | | | |
| Grocery | 57.0 | 58.0 | 58.0 |
| Meat | 38.0 | 36.0 | 35.7 |
| Produce | 5.0 | 6.0 | 6.3 |
| Total sales | 100.0 | 100.0 | 100.0 |
| Gross profit: | | | |
| Grocery | 15.54 | 14.81 | 14.33 |
| Meat | 17.83 | 16.54 | 16.92 |
| Produce | 26.72 | 24.83 | 26.97 |
| Total gross profit | 16.98 | 16.02 | 16.06 |
| Less operating expenses: | | | |
| Direct: Wages | 4.70 | 4.93 | 5.71 |
| Mgt. salaries | 1.70 | 1.37 | 1.23 |
| Supplies | .97 | .97 | 1.08 |
| Advertising | .80 | .82 | 1.06 |
| Family stamps | 2.50 | .94 | |
| Sales promotion | .02 | 1.05 | .10 |
| Total Direct | 10.69 | 10.08 | 9.18 |
| Total Indirect | 2.79 | 3.57 | 3.79 |
| Total expenses | 13.48 | 13.65 | 12.97 |
| Net operating profit | 3.50 | 2.37 | 3.09 |

Even if a store's net income appears to be in line, it is usually advantageous to study the gross profits of each department to see if they are in line. As indicated in figure 5, if gross earnings in any one department are low, a check should be made on sales; the sales balance between departments and the gross contribution of the department are first measures of how well the department is doing. Then the amount and sources of shrinkage, the efficiency of operations, and the matter of pricing practices and balance are looked into. (See appendix for checklist of questions.) After the retailer is satisfied that the gross earnings in each department are reasonable, expenses should be analyzed. First, direct and allocated costs such as wages, management salary, supplies, repairs, and miscellaneous expenses should be compared for the current period, the year to date, and the same period last year. Then, indirect and nonallocated costs, such as rent, utilities, advertising, trading stamps (if any), and insurance should be compared.

An analysis of store operating data, such as suggested above, does not necessarily entail long hours of study. A review of the accounting information, as it is made available each month, gives a retailer added familiarity with his store's operations, and after he has read his statements in this systematic way several times, a single hour devoted to the data can be one of the most profitable in the retailer's work week. The value of a regular review is that trouble may be spotted early, and, when a problem has been identified, steps looking toward its solution are often made evident.

The following case study is a good example of how systematic reading of the income and expense statement can help improve operations.

## Case Study D

When the owner of a store in a Michigan city of 100,000 population received his statement for 14 weeks in 1958, he was surprised to find that he had a net loss of one percent. He immediately reviewed his gross profit figures for each department and found that his profit on meat and produce had fallen far below his year-to-date figures and his last year's figures. The meat gross profit was 15.60 percent and the produce gross was 13.52 percent. The owner then looked into each expense category directly chargeable to these departments and found them to be in line with that obtained by similar stores in the area.

The owner called the wholesaler's retail accounting department to get their view on his situation. The accounting department representative visited the retailer and reviewed his statements. He agreed that the perishables gross was too low, but also pointed out that the grocery profit was too high. The accounting department felt that the high gross profit on groceries (18.50 percent) caused the market to lose many customers, and the fact that prices of perishables were low did not help because customers also compare prices of frequently purchased grocery items. The accounting department suggested that the store get its prices in better balance by promoting grocery items more heavily.

The accounting department representative also suggested that the low meat gross could be the result of poor cutting, as well as pricing. Production methods and buying practices in the produce department were also suggested as a possible reason for the low gross. After careful study in each department, the store's difficulties were traced to poor pricing policies in all departments and poor operations in the perishables departments, particularly in meat cutting and produce trimming.

The wholesaler's meat supervisor verified the views of the accounting office in the meat department. He found that poor cutting resulted in excessive waste. In the produce department, buying practices were changed and produce was trimmed more carefully. In the past, buying of low quality produce had resulted in quick spoilage, and frequent retrimming was necessary. Purchasing of only the highest quality produce was begun, and trimming was supervised by the owner for a while. Prices in meat and produce were better balanced but were not generally increased; grocery prices were made more attractive.

The operating statement for the first quarter of 1959 indicates that these steps were helpful. Expenses were reduced from 18.33 percent of sales to 17.21 percent and sales increased to about $6,000 per week. Although sales per customer were not available for the 1958 period, this ratio stood at $3.09 for the 1959 period, which is considered good for a store of this size. Net profit was increased from a loss of 0.97 percent of sales to a profit of 1.26 percent of sales.

Comparative Income Statements
Michigan Store

| Item | First quarter 1958 | | First quarter 1959 | |
|---|---|---|---|---|
| | Sales | Percent of sales | Sales | Percent of sales |
| Sales | | | | |
| Grocery | $50,541.56 | 64.81 | $51,641.51 | 63.91 |
| Meat | 21,978.41 | 28.19 | 24,304.65 | 30.08 |
| Produce | 5,452.51 | 7.00 | 4,850.68 | 6.01 |
| Total sales | $77,972.48 | 100.00 | $80,796.94 | 100.00 |
| Gross profit | | | | |
| Grocery | | 18.50 | | 17.43 |
| Meat | | 15.60 | | 18.40 |
| Produce | | 13.52 | | 26.91 |
| Total gross profit | | 17.33 | | 18.29 |
| Total operating expenses | | 18.33 | | 17.21 |
| Net operating profit | | -1.00 | | 1.08 |
| Other income | | .03 | | .18 |
| Net profit | | -.97 | | 1.26 |

Case study D demonstrated how expert interpretation of the operating figures made it possible to turn a failing operation into one in which the owner could make a living. The following is a case study from another Michigan store in which this same kind of analysis led the retail accounting office to advise the owner against trying to improve the operation, but rather to seek a new location.

## Case Study E

This store had a weekly volume of about $4,800 in 1956. For the year 1956 the store's operation was slightly below the break-even point, with a loss of $412 or 0.17 percent. The owner of the store called the retail accounting office and asked their advice on how the store could be improved. In a meeting with the owner, the accounting office reviewed the recent income statement. Total gross profit was 19.38 percent, with a departmental breakdown of 17.06 percent for groceries, 21.90 percent for meat, and 25.76 percent for produce. The accountant pointed out that the gross probably could not be increased in any department.

The expenses were analyzed next in an effort to reduce one or more of them. Each of the direct costs was analyzed separately. All of the direct costs except wages appeared to be in line. Store wages (exclusive of management salary) were 8.10 percent. However, this store carried a heavy delivery expense because it had no parking space, and the accountant and the owner agreed that reducing delivery service would also reduce store sales. The other item considered was trading stamps. This expense of 1.84 percent for stamps was below the normal 2 percent stamp expense. But it was felt that this expense could not be eliminated because of the competitive situation; a reduction here would result in a loss of sales, also. The fixed expenses were analyzed thoroughly, but all were in line. The lack of parking made it almost impossible to increase sales, regardless of the amount of advertising or sales promotion.

The accounting office and the owner finally agreed that the best course would be to sell the store and find one in a better location. The owner sold the store, and with the help of the store development office of the wholesaler, found a good location with a large parking area. The new store had a selling area of 7,000 square feet. The operating statement for the year of 1958 shows that the correct decision was made. Sales were nearly $12,000 per week, or more than twice the level of the other store. Although gross profits in each department were reduced, net profit on increased sales rose to 2.04 percent. Labor expense in the new store was 7.9 percent with delivery available to the customer at a fee. A check on the amount of sales per customer showed that in this important ratio there was an increase from $2.79 in the old store to $3.30 in the new one.

Comparison of Income Statements
Old Store and New Store

| Item | 1956 (Old store) | | 1958 (New store) | |
|---|---|---|---|---|
| | Dollars | Percent of sales | Dollars | Percent of sales |
| Sales: | | | | |
| Grocery | 151,424.17 | 61.20 | 396,739.99 | 65.06 |
| Meat | 67,950.93 | 27.46 | 166,798.97 | 27.33 |
| Produce | 28,052.10 | 11.34 | 46,710.08 | 7.61 |
| Total sales | 247,427.20 | 100.00 | 610,249.04 | 100.00 |
| Gross profit: | | | | |
| Grocery | 25,832.34 | 17.06 | 65,369.18 | 16.47 |
| Meat | 14,880.79 | 21.90 | 32,926.09 | 19.74 |
| Produce | 7,226.13 | 25.76 | 10,112.14 | 21.67 |
| Total gross profit | 47,939.26 | 19.38 | 108,417.41 | 17.77 |
| Less operating expenses: | | | | |
| Salaries (Management) | 4,160.00 | 1.68 | 5,200.00 | .86 |
| Wages | 20,048.31 | 8.10 | 42,995.51 | 7.04 |
| Advertising | 2,307.12 | .93 | 5,474.43 | .90 |
| Stamps | 4,559.19 | 1.84 | 6,875.42 | 1.12 |
| All other | 19,123.09 | 7.74 | 43,866.40 | 7.19 |
| Total expenses | 50,197.71 | 20.29 | 104,411.76 | 17.11 |
| Net operating profit | (2,258.45) | (.91) | 4,005.65 | .66 |
| Other income | 1,846.21 | .74 | 8,473.94 | 1.38 |
| Net profit | (412.24) | (.17) | 12,479.59 | 2.04 |

## CONCLUSIONS

This report has described how food retailers can use store accounting data to review and improve store operations. The case studies cited in the report and in the appendix are concrete illustrations obtained during this study, showing how retailers have used their accounting information effectively.

In order to get the most out of their accounting system, retailers need:

1. An adequate accounting system which they can maintain.

2. A knowledge of how to read their income and expense statement and supporting data, such as operating ratios. (Figure 5 is a useful guide for reading accounting information.)

3. Some means of comparing operating figures for the current period with those for a comparable previous period of their own store, or with those of a group of similar stores in their trading territory. If available, both sets of figures are preferable.

For many retailers these needs can be met by participating in the retailer accounting system of a wholesaler-retailer organization. The wholesaler's accounting department is likely to be familiar with retail food store operations generally and with the affiliated retailer group particularly. Moreover, by using a common accounting system, comparisons between stores are valid, and the wholesaler can facilitate comparisons by preparing composite statements for groups of stores having about the same volume of business.

Accounting service is another expense for the retailer and needs to be scrutinized carefully as to cost and contribution to the store's profitable operation. Accounting is also a tool of store management and, used effectively, can save far more than it costs.

APPENDIX

## Checklist for Investigating Causes of Poor Gross Profit

### Procedure for Receiving Merchandise

1. Are weights checked for merchandise billed on weight basis, especially items having the most shrinkage?

2. Are invoices checked when goods arrive, and are errors reported and taken into account in paying invoices?

3. Are quantities checked on daily deliveries of items such as bread, milk, pastries, cottage cheese? Is this task clearly assigned to one responsible person and is he instructed in what to watch for, how to handle shorts, and when to o.k. merchandise received?

### Procedure for Assuring Employee Integrity and Checkout Control

1. Is each person who handles cash registers honest and accurate? (Checkers can ring sales up short and pocket the difference, short-change the customer, mark down amounts as refunds which have not been made at all, and pocket the amount.) Are checkers instructed in the mechanics of checking which will minimize errors?

2. Are service doors secured at all times? Are the rear door, the basement door, etc., barred from the inside when unattended? Is a responsible person assigned to the backroom when the door is opened for deliveries?

3. Are the manager and other key personnel alert to possible pilferage going on within the stores? Are they instructed in how to detect petty thievery?

4. Are coupons, stamps, etc. treated as cash? Is each person handling them instructed in their care and control?

5. Are the scales accurate and are they being used properly? Are responsible personnel alerted to the cost of inaccurate weighing, either in customer good will or in store net profit? Merely to have the sealer approve of scales is not sufficient.

6. Is there an accurate method of checking cash daily and if a shortage or overage occurs, is it followed through immediately to find out how it happened and who was responsible?

## Shrinkage of Merchandise

1. Is an accurate record kept of shrinkage on perishable merchandise? Is there a record of spoilage?

2. Are department managers and other key personnel instructed in how to care for perishables and how to make the best use of store facilities provided for their care?

3. Is the inventory on meat or produce too high--especially over weekends? (Shrinkage through moisture loss is very rapid on all products in which water is a predominant part.)

## Procedure for Pricing and Accounting of Merchandise

1. Is there a periodic check on pricing of merchandise on the invoice, particularly where price extensions are made by hand rather than mechanically?

2. Is an accurate physical inventory taken at the end of each period and unusual differences between periods checked into?

3. Are promotional price discounts budgeted and the cost charged to "Promotions?" Is the sale merchandise put back to regular price immediately after the sale?

4. Are the manager and other key personnel instructed to take all market advances as they occur, and to take declines when they occur?

## Review of Product and Price "Mix"

1. Gross earnings are determined by the margin of profit on all the items sold. Good gross earnings require a balance in sales between low- and high-margin items. Produce, frozen foods, and many new prepared foods are in the higher margin category and should be given special attention. Is space allocation and department arrangement designed to encourage shopping for these items?

2. Are key personnel in the store aware of profitable lines and instructed in how these lines may get a fair share of the business?

3. Is there a periodic check of the meat department cuttings to assure proper number and balance of cuts?

## Checklist for Investigating Causes of High Expenses

### Wages and Salary Expenses

1. Is the work organized properly: Between departments? Between individuals within each department? Between full-time and part-time employees? Between shifts and across the week? Is a high payroll, incurred during peak selling periods, maintained when business has slackened? (Frequent "stand-around time," or waiting for assignments, or for one group to complete a job before others can begin theirs are evidence of faulty work organization.)

2. Are the working facilities adequate and properly used: What is the situation for receiving groceries? For perishables? What is the condition of workspace and equipment for handling perishables? Are personnel instructed in the proper use of such devices as conveyors, dollies, and handtrucks as work-savers?

3. Are good work methods used: Has each major job in the store been studied recently to see if it can be done with less effort and in less time? Has the recent research in work simplification for retail food stores been studied? (The Agricultural Marketing Service has been conducting such research and a list of published reports is available on request.)

4. Is the morale and motivation of employees good: Is there a feeling of camaraderie among employees, or the air full of bickering? Tardiness, absences, and idleness on the job are often associated with poor morale--are there evidences such as this in your store? Has the recent research on employee morale and motivation been studied? (The Agricultural Marketing Service has done some research in this area for retail food stores.)

5. Management salaries: Management salaries are an expense like those of other employees. Are management salaries consistent with the store's volume and with the wages paid to department heads?

### Other Direct and Allocated Expenses

1. Store supplies and linens: Are costs for supplies and linens allocated for each department and are they consistent with department volume and usage? Have employees been informed on ways of conserving store supplies and linens and the contribution to store income of even small savings of this kind?

2. Promotions: Grocery department promotions--special selling of regular merchandise at less than regular margins--may be treated as an expense. Is the cost of promotions calculated and recorded as an expense? Are promotion expenses kept within budget limits and the value of each promotion determined?

3. Repairs and maintenance: Fixtures and equipment need repairs from time to time, and careful maintenance can help reduce the need for costly

repairs. Is the system for periodic checking on the condition of equipment and responsibility for maintenance clearly defined?

## Indirect and Nonallocated Expenses

1. Power and utilities: Rates for utilities are fixed, but use of power and electricity, and of telephones can be controlled. Have employees been instructed in the use and conservation of electricity? Are pay telephone facilities available for necessary personal calls by employees?

2. Depreciation and obsolescence: Depreciation of fixtures and store facilities is an expense but should be fully charged each year in order to build reserves for replacement. Is the maximum depreciation allowance being taken for reserve and tax purposes?

3. Insurance: Insurance rates will vary little for the kind of coverage needed by retail food stores, but since the rates are based on apparent risks, they may be modified somewhat. Have efforts been made to reduce the likelihood of fire and of customer and employee accidents? Has the insurance agent been apprised of these actions and their results?

## Case Studies

The following case studies are among the 18 that were obtained in conducting the research. Like the case studies cited in the report, they illustrate how retailers have used accounting data to locate weaknesses in their operation and to help solve problems with which they were confronted.

### Case Study F

Poor management and control of ordering procedures result in low gross profit in grocery and produce departments.

In the fall of 1956, the owner of an Indiana superette reviewed his financial statements and found that his net profit had almost disappeared. With the aid of the wholesaler's fieldman the operating data were carefully analyzed. Gross profits were found to be particularly low in the grocery and produce departments, but slightly above normal in the meat department.

Gross profit in the grocery department was 10.30 percent, and for produce it was 15.00 percent, while the meat department maintained a 21.70 percent gross profit. In the grocery department the first step was to check shelf prices against suggested retail prices in the order book. This revealed that price changes were not being made. Further, a general laxity in controls over operations prevailed. There was no systematic control over receiving and no method for checking merchandise in the store. A procedure was set up for making price changes and for receiving merchandise, and employees were instructed to have their purchases checked out by the owner. Gross profits in the grocery department increased from 10.30 percent to 12.15 percent for the first quarter of 1957. This was slightly above the grocery gross profit of stores of similar size in that area.

In the produce department, pricing seemed to be reasonable, but there was a shrinkage problem. It was found that a low quality produce was being purchased and that the produce display cases were obsolete, calling for frequent "wetting down," which was often overlooked by store personnel. The produce manager was made responsible for ordering, and he was instructed to buy only first quality merchandise. Racks were "wet down" more regularly and display tables were cleaned and redecorated. The reduction of shrinkage through high quality and better handling proved profitable, as gross profit was increased to 19.14 percent in the next quarter.

Net profit was increased from 0.36 percent to 2.47 percent in the following quarter through a substantial reduction in the cost of sales from 86.84 percent to 84.65 percent.

| | 1956 | First Quarter 1957 |
|---|---|---|
| | Percent | Percent |
| Sales | 100.00 | 100.00 |
| Cost of goods | 86.84 | 84.65 |
| Gross profit | | |
| Grocery | 10.30 | 12.15 |
| Produce | 15.00 | 19.14 |
| Meat | 21.70 | 21.52 |
| Total gross profit | 13.16 | 15.35 |
| Total expenses | 12.80 | 12.88 |
| Net profit | .36 | 2.47 |

## Case Study G

The opening of a regional shopping center imperiled the success of a nearby independent food retailer.

A modern 12,000-square foot supermarket operation by two men with long experience in food retailing began to have difficulty when two chain-operated food stores opened in a newly developed shopping center across the street. Sales for the fiscal year ended August 30, 1957 averaged $38,850 per week. The effect of the new competition is apparent in the income statement for the last 4 months of 1957--sales dropped to $35,200 per week. The owners had already taken steps to compete with the chain stores; in July they joined a wholesaler-sponsored voluntary group, and they began to offer trading stamps.

But after reviewing their year-end income statement they realized that something more needed to be done and called on the voluntary group coordinator and asked for his ideas. After studying the sales and earnings figures, and the costs for promotion, the coordinator suggested that the advertising and merchandising should compete directly with these two chains and offered these specific proposals:

1. Increase advertising budget. (Start distributing handbills regularly.)

2. Review and adjust prices of all items to compete with chains.

3. Promote stamps more actively.

4. Increase customer services, such as free telephone, and facilities for paying utility bills and buying money orders.

These suggestions were followed by the owners, and subsequent operating statements show an increase in sales and operating profit. The income statement for the year ended August 30, 1958 reveals that sales increased to $37,000 per week and operating profit before depreciation increased to 1.09 percent of sales. Wage costs were reduced from 6.82 to 6.10 percent of sales through better work organization and a reduction in officers' salaries.

| | Year ended 8-30-57 | 4 months ended 12-31-57 | Year ended 8-30-58 |
|---|---|---|---|
| | Dollars | Dollars | Dollars |
| Weekly sales | 38,850 | 35,220 | 36,940 |
| | Percent | Percent | Percent |
| Cost of goods | 84.69 | 84.73 | 84.46 |
| Gross profit | 15.31 | 15.27 | 15.54 |
| Expenses | | | |
| Stamps and premiums | .11 | 2.16 | 2.21 |
| Wages (including draw) | 6.19 | 6.82 | 6.10 |
| Advertising | .97 | 1.02 | 1.41 |
| All other expenses | 6.22 | 4.98 | 4.63 |
| Total expenses | 13.49 | 14.98 | 14.35 |
| Operating income (before depreciation) | 1.82 | .29 | 1.09 |

## Case Study H

Merchandising policies and inadequate supervision result in low grocery and produce gross profit.

This market has a sales volume of about $9,000 per week, in a selling area of about 2,500 square feet. The store is located on the edge of an industrial area so that its market is limited substantially in one direction. The owner of the market was aware that his net operating profit was dangerously low for the first quarter of 1958. On examining his quarterly statement he found that his net profit was 0.73 percent of sales. The statement indicated that his total expenses were in line at 15.84 percent of sales. In reviewing the departmental gross profits he found that the grocery gross was low at 15.08 percent, and that produce gross profit was only 21.52 percent. The meat gross, at 19.09 percent was close to the 20 percent recommended by the accounting office. The accounting office representative called in to study the statement recommended that the owner try to increase his grocery profit by increasing the sale of impulse items. In consultation with the fieldman it was suggested that he display high profit items that tie-in with his price leaders, and that it may be profitable to give his drug items more display space. These recommendations were followed.

A study of the causes for the low gross profit in the produce department disclosed that shrinkage was high, and the owner felt that a new produce case might be necessary. The owner called the wholesaler's store development section to examine the produce case and, if necessary, recommend the type of case he should buy. It was agreed that a new case was advisable and a 16-foot dryrack was recommended and bought. The owner also began to supervise produce ordering and trimming procedures.

The comparison of the income statement for the first quarter of 1958 with the first quarter of 1959 showed that sales increased from $8,400 per week to $9,000 per week. Sales per customer increased from $3.18 to $3.42, and gross profit in groceries was up from 15.08 percent to 17.39 percent, produce from 21.52 percent to 23.06 percent, while meat was down slightly to 18.50 percent. The total gross profit rose from 16.29 percent to 17.97 percent, while expenses held fairly constant, rising only 0.49 percent.

| | First Quarter 1958 | First Quarter 1959 |
|---|---|---|
| | Dollars | Dollars |
| Weekly sales | 8,375 | 9,022 |
| | Percent | Percent |
| Gross profit | | |
| Grocery | 15.08 | 17.39 |
| Meat | 19.09 | 18.50 |
| Produce | 21.52 | 23.06 |
| Total gross profit | 16.29 | 17.97 |
| Expenses | | |
| Wages (including mgt. salaries) | 6.68 | 6.75 |
| Advertising | 1.07 | 1.12 |
| Stamps | 2.28 | 2.24 |
| All other expenses | 5.81 | 6.22 |
| Total expenses | 15.84 | 16.33 |
| Net operating profit | .45 | 1.64 |
| Other income | .28 | .43 |
| Total net profit | .73 | 2.07 |

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